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STATEMENT ON STEEL

BY

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DIRECTOR OF PRICE STABILIZATION

BEFORE THE

SENATE COMMITTEE ON LABOR AND PUBLIC WELFARE

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PRESENTED BY MR. MORSE

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STATEMENT ON STEEL BY ELLIS ARNALL, DIRECTOR OF PRICE STABILIZATION, BEFORE THE SENATE COMMITTEE OF LABOR AND PUBLIC WELFARE, WEDNESDAY AFTERNOON, APRIL 16, 1952

This committee has requested me to testify on the price aspects of the present crisis in the steel industry. Thus far I have not discussed this subject extensively in public. I have carefully refrained from doing so while private negotiations were in progress and there was some hope that they might lead to a settlement.

Now, however, this dispute has become a matter of large public interest, in which the Congress must have a deep concern. Therefore, I can only welcome this opportunity to acquaint the Congress fully and in detail with the position of the Office of Price Stabilization and with the facts upon which our position is based.

Relation of wage and price stabilization policies

It is a matter of regret to me that price-stabilization policies have become enmeshed in a labor dispute, or even in a problem of wage stabilization. Wage and price control are closely related in the sense that both are part of a larger stabilization program. Both must be subject to mutually consistent rules or policies which bring about sound and effective stabilization of prices and wages. Nevertheless, it has been my view, and the view of my agency, that the day-to-day administration of these controls must be kept separate. We have never believed that a wage increase which is appropriate in terms of sound wage stabilization standards should be denied merely because that increase might require higher ceiling prices. Nor, on the other hand, do we believe that a wage increase which is in excess of sound wage stabilization standards should be approved merely because that wage increase would not require higher price ceilings. We believe that once the stabilization framework has been set up, rules of equity should govern wage decisions, and a similar set of principles should be used in judging the propriety of requested price increases. To base either wage or price decisions upon the consequences in the other field would be to abandon those rules of equity in relation both to labor and to business.

To say this is certainly not to say that price-control officials can ignore the movement of labor costs any more than to say that wage-control officials can ignore movements in the cost of living. Under the Defense Production Act, ceiling prices must be generally fair and equitable. Clearly, ceiling prices which are indefinitely maintained in the face of rising business costs may no longer be generally fair and equitable. In this respect labor costs must receive the same consideration as any other kind of costs. An increase in labor costs may render a previous ceiling price no longer fair and equitable in the same way as an increase in transportation costs, raw material costs, or any other element of sellers' necessary expense.

Standards for approving price increases

One of the principal tasks of price-control law and administration must be to develop rules and procedures under which sellers who have experienced cost increases may ask for and, in appropriate instances, receive ceiling price increases. In our view the request by the steel industry for higher prices is simply one of a large number of similar requests. We receive such requests every day.

In order to decide which requests for price increases should be granted and which should be denied, we must have rules by which we can say "No" to some demands for price increases, and "Yes" to others. Without such rules, price control could not operate. If price increases were permitted because the people in an industry were "gentlemen," or belonged to the right political party, or because they screamed the loudest, government by law would have disappeared, and freedom and individual rights would have perished.

In judging the need for price increases we must look first at the provisions of the law itself. Two of the standards established in the Defense Production Act are relevant to the present case. The first is specific. It is section 402 (d) (4)—the so-called Capehart amendment—under which OPS must permit price ceilings to be raised so that they equal pre-Korean selling prices plus all increases or decreases in costs up to July 26, 1951. Until the present wage negotiations began, none of the steel producers had applied for such adjustments. Late last year, however, several members of the industry indicated that they wished to be permitted to adjust their ceiling prices in accordance with this provision of the act. The law requires that these requests be granted. Actually, however, the Capehart provision is completely independent of the wage negotiations and properly has no relationship to cost increases arising since July 26, 1951.

We had already issued regulations informing other industries how to apply for Capehart adjustments. However, because of the complexity of the steel industry's price-cost structure, the development of a regulation prescribing the manner in which steel producers could submit such applications has taken considerable time. Consultations with the industry on the final form of the regulation were postponed at the request of industry representatives who apparently felt that the price increases involved were too low to be acceptable in the present crisis. We stand ready at any time, however, to grant the industry—or any member of it—the full measure of price relief required under this provision of the act.

The second relevant provision is more general. The Defense Production Act lays down the requirement that price ceilings must be "generally fair and equitable." To carry out this direction the OPS, with the approval of the Economic Stabilization Administrator, has issued the Industry Earnings Standard. This is the principal OPS standard used for determining which price increases should be granted and which should be denied, and it applies to the case under discussion. Briefly stated, this standard requires OPS to raise prices for an industry if and when its return on the owner's investment. before taxes, falls below 85 percent of the level enjoyed in the best three of the four prosperous years 1946 through 1949. I am sure you recognize that this standard is very similar to the one Congress used in the excess-profits-tax law. Stated broadly, then, ceiling prices will be raised when an industry generally falls out of the excess-profits-tax bracket.

The Industry Earnings Standard

Most requests for price increases, and thus most occasions for the application of the Industry Earnings Standard, come when an industry has experienced cost increases. Price stabilization would be a mockery if all cost increases were automatically passed on in the form of higher ceilings. If this were done, the spiral of higher wages, higher prices, higher parity, higher cost of living, higher wages, and so on, would operate unchecked. When steel—or any other industry—tells us it has incurred higher costs and needs a price increase, we find out whether these higher costs can reasonably be absorbed out of abnormally high profits. If they cannot, the price increase is permitted. But if absorption of the cost increase would still leave a fair return, or more than a fair return, the price increase is denied. This is reasonable, it is fair, and it is the way business itself normally operates.

Cost increases cannot be absorbed without limit. The Industry Earnings Standard is our limit on required absorption of cost increases. This standard protects a level of profits as high as those realized in a normal, prosperous, peacetime period, during which industry produced at a high level and expanded at a rapid rate. Profits that high are high enough to provide adequate incentive when the Nation is in danger.

The standard is legally sound as an interpretation of the requirement embodied in the Defense Production Act that price ceilings be fair and equitable. Based on identical language in the wartime price-control legislation, OPA used an almost identical standard and this standard was upheld by the highest courts time after time.

Of course, no single rule can be devised which is uniformly equitable in all cases. The OPS Earnings Standard recognizes this by making special provision for those cases where its rigid application would be unfair or unreasonable. Thus there are cases where an industry's earnings during the 1946–49 base period were abnormally low or otherwise unrepresentative, and for which the standard consequently makes special provision.

Base period highly profitable for steel

In the case of the steel industry, however, the 3 years from 1947 through 1949 were the most profitable the steel industry had experienced since World War I. This is clearly demonstrated in the chart which I should now like to show you. This chart is based upon data supplied by the Federal Trade Commission to the Joint Committee on the Economic Report in 1949, and supplemented for recent years by the FTC at our request.

While the general impression which this chart gives requires no comment, I might supplement it with a few numbers. During 1947–49, which are the best 3 of the 4 base-period years, the industry averaged almost 19 cents' profit before taxes on every dollar of stockholders' investment, or net worth. The second best 3-year period since 1919 was the period 1941–43; during this period, earnings averaged about 17½ cents per dollar of stockholders' investment. During only two other years (1929 and 1944) did earnings exceed 11 cents. The average of the 1920's was 8.5 cents. The average of the thirties was 2.0 cents. And the average of the forties was 15 cents.

After income taxes, the 1947–49 period provided a higher average rate of return than did any single year between 1918 and 1947.

Obviously, the base period for the Industry Earnings Standard was an extremely favorable one for the steel industry. Even if earnings were to fall to the level of that period, the steel industry would still be unusually prosperous. As I shall show you shortly, however, there is no immediate prospect that this will occur. In order to show you this, I will first have to show you how much the wage increase recommended by the Wage Stabilization Board would cost the steel industry.

The cost of the wage recommendations

I am sure you already have in your record the specific proposals made by the Wage Stabilization Board for the settlement of the economic issues in the dispute. We have computed the cost of these proposals to the industry, including the cost arising from the application of higher wage rates to overtime pay, vacation pay, pensions, social security, and so forth. We also have taken into account the industry's custom of giving its salaried employees an increase equal in percent, rather than cents per hour, to the wage increase granted to plant workers. I believe that I need not go into these computations in detail, since I can assure you that our figures have been checked with the industry's own experts and there is no difference of opinion about them.

Nor is there any difference as to the translation of the cost per hour into cost per ton of finished steel. Industry experts agree with us that it takes 17 man-hours to produce a ton of finished steel. This includes the time spent in operation of coke ovens, blast furnaces, steel-making furnaces, and rolling mills, as well as the time of clerical, administrative, and sales forces. There is also agreement that three more man-hours are needed to produce the iron ore, coal, and limestone required to make a ton of finished steel. Thus, if we multiply the hourly cost increase by 17, we find how much more it would cost to produce a ton of finished steel in the steel mills; and if we multiply it by 20, we find how much more it would cost to produce a ton of steel in a fully integrated operation—including coal, iron ore, and limestone—if workers and employees in all parts of that operation get the same wage increase at the same time.

In this fashion we arrive at the figures represented by a chart which I would now like to show you.

Looking first at the cost increase that would arise if the proposed wage increase were put into effect in the steel mills only, you see that it would amount to $2.96 for each ton of finished steel in the first half of 1952. Beginning next July it would amount to $3.89, and for the whole year 1952 it would average $3.43. Next year the figure would be $5.05, and the cost for the entire proposed contract period of 18 months would be $3.97—that is, if the entire proposal were put into effect in the steel mills as recommended by WSB: Wage increases, fringe improvements, and all indirect effects on labor cost.

If you look at the higher figures applying to a fully integrated operation, you find that the cost increase would amount to $3.49 in the first half of 1952, to $4.58 in the second half, averaging $4.03 for all of 1952. After January 1, 1953, it would be $5.94, and the average for the 18 months would be $4.67.

As I mentioned before, these higher figures are based on the assumption that wage increases in coal and ore mines and in limestone quarries would equal those in the steel mills as to both terms and effective dates. Therefore, those higher figures give a slightly exaggerated picture of the labor-cost increase which the steel industry would face if it accepted the recommendations of the Wage Stabilization Board. The coal miners have not yet asked for a wage increase and, whenever they will receive one, it will not be retroactive to January 1, 1952.

Labor productivity rising

The chart also fails to take account of the increase in productivity which is likely to occur during the 18 months which would be covered by the proposed contract. In the past the industry's wage increases have been partly offset by gains in productivity. While the industry pays more for each hour of labor, it needs fewer hours to produce a ton of steel. This is clearly illustrated by the postwar experience shown on my next chart.

I may explain this chart very briefly. Disregarding for a moment the line at the top, I want you to look at the highest of the other three lines. It represents the steel industry's employment costs per hour, which include the cost of vacations, pensions, social security, and all other fringe benefits as well as wages. As the line shows, these costs rose 37.6 percent from 1946 to 1950. During the same period, however, the lowest line on the chart shows a decline of 17.2 percent in the number of man-hours needed to produce a ton of finished steel. That is the reflection of increasing productivity. The net result of increasing employment costs per hour and declining hours per ton is shown by the line between the two I just discussed. It represents the industry's employment cost per ton of finished steel, which went up but much less than the employment cost per hour. It rose only 13.8 percent during this period—a little more than a third as much as the employment cost per hour.

Parenthetically, I may now refer to the top line on the chart. It simply shows that during this postwar period steel prices were increased 55.2 percent—rising very much more than the industry's labor cost.

That, however, is not the main point I wish to make with this chart. Its purpose is to show you that, due to increase in productivity the industry's labor cost per ton of steel has risen much less than its employment cost per hour, which is the subject of any wage settlement.

The productivity gain, of course, is not as important over a short period as it is in the long run. During the next year or two, however, it should be quite significant, since a number of new and more efficient plants are coming into production. Nevertheless, we are ignoring this factor in our computations, to be sure that our figures are more than fair to the steel industry. I hope, however, you will not forget that improved productivity is bound to assist the industry significantly in offsetting whatever cost increase it may have to absorb.

The industry's claim to $12 per ton

The figures which I have just cited show conclusively that the maximum increase in employment costs which would result from adopting the Wage Board's recommendations would be less than $6 per ton. This highest possible figure may be regarded as representing either the expected increase in employment costs during the first half of 1953 after the third step goes into effect, or it may be regarded as representing the average increase in employment costs for the 14-month period, April 1952 through June 1953, including an allocation to these 14 months of the cost of the retroactive increase for the first 4 months of the current year. The increase in employment costs during the remainder of 1952 will be considerably less than $6. Moreover, as I have said, these figures take no account of the increase in productivity which may be expected to occur during the next 12 or 15 months.

These estimates of the increase in employment costs resulting from the Wage Board's recommendations are in every respect consistent with the estimates prepared by the steel companies themselves. Yet, representatives of the industry claim that the increase in total production costs will be not $6 but $12 per ton. They justify this position by asserting that historically every increase in employment costs has been paralleled by an approximately equal increase in the cost of purchased goods and services. Consequently, they say that if $6 represents a fair measure of the increase in employment costs, we must add another $6 per ton to cover the expected increase in the costs of the products and services they buy, and thus arrive at the $12 figure which has been given so much publicity.

For reasons which I will come to in a moment, I believe that the industry's forecast of the increase in the cost of purchased goods and services is utterly unrealistic and that it is based on a series of false premises. However, I have no objection in principle to any estimate which the industry may wish to put forward as to what may happen in the future with respect to either its costs or its profits. Prophecy is at best a hazardous art and I lay claims to no special qualifications as a prophet. The nub of the issue, however, is not that the industry foresees the possibility of having to pay higher prices for goods and services at some time in the future, but rather that it lays claim to a price increase now sufficient to compensate it for such assumed subsequent cost increases.

There are two kinds of reasons which impel me to take a very firm position on this issue. The first, and overwhelmingly the more important, is that a matter of principle, price stabilization would become a futile gesture—in fact, worse than futile—if we were to take into account an industry's guesses, whether or not well founded, as to what might happen to its costs at some future date. The second is that the industry's forecasts in this instance seem wholly out of line with any reasonable expectation of what is in fact likely to occur.

The first point would seem almost too obvious to dwell upon were it not for the firmness with which the steel industry maintains its position. It seems clear to me that, as Director of Price Stabilization, I can take into account only those cost increases which have, in fact, occurred, or are certain to occur. If OPS were to grant price increases to any industry based upon its fears as to what might happen in the future, the result would obviously be to stimulate inflation rather than to hold it in check. As far as I know, no regulatory commission in the history of this country has ever granted price increases on the basis of unverifiable—and, in fact, unreasonable—claims as to what might happen to commodity costs in the future. Nor has any other industry asked the Office of Price Stabilization for such treatment. If we were to treat the steel industry on this basis, we would, in simple logic, have to grant every other industry price adjustments based upon uncertain forecasts as to what the general level of its production costs might be a year hence. Labor might then properly insist that wages be adjusted today to take care of projected increases in living costs that might occur in the future. Yet, absurd as such a course would seem, this is—I repeat—the issue upon which we are now split and toward whose resolution we have made absolutely no progress.

While I regard this conclusion of principle to be unassailably sound and wholly sufficient by itself, some comment may be appropriate with respect to the basis upon which the representatives of the steel industry have rested their contention. The United States Steel Corp., for example, states that since 1936 its average employment costs per ton and the cost of purchased products and services per ton, have each approximately doubled. On this basis, it is argued, there is a dollar-for-dollar correspondence between each change in employment costs and in the cost of materials and services. This conclusion is fallacious for a considerable number of reasons.

In the first place, what is true over the long run is distinctly not valid for the short run. Ultimately, of course, both wage rates and materials costs are affected by the same general economic conditions. From year to year, however, there is no such close correspondence and they may even move in opposite directions. In particular, it is unrealistic to expect a sharp increase in materials costs during a period when price controls are in force.

Moreover, even if some materials costs were to increase over the course of the next year, such increases would be gradual and not immediate. Assuming that such an increase in materials costs were to proceed at an even rate, it would be necessary for the average cost per ton of materials and services purchased by the steel industry to rise by $12 between now and June 1953 in order to achieve an average cost increase of $6 over that period. Since the total present cost of materials and services per ton is about $50, this would imply a materials cost increase of almost 25 percent over the next 14 or 15 months. Even the wildest alarmists foresee no such catastrophe. To base price control policy upon an assumption of this kind would seem utterly indefensible.

The fallacy of the steel industry's position may be further demonstrated by looking at the record of the past few years. In the middle of 1948 there was a substantial wage increase which raised employment costs per ton between $3 and $4. Materials costs per ton, however, remained steady throughout the entire period from the beginning of 1948 until the Korean outbreak.

Similarly, the last general increase in steel wages occurred in December 1950. This increase raised employment costs per ton by about $3.80 on the average. At the same time, steel prices were raised by an amount in excess of $8 per ton. Yet, our figures indicate that since December 1950 there has been virtually no net change in the cost of purchased services and materials for the steel industry. Actually, the cost of the most important single item purchased by the steel industry—steel scrap—was reduced as a result of action taken by OPS and is now lower than it was in December 1950.

It is true that in the past the steel industry has often followed the practice, when granting wage increases, of raising its prices by a substantially greater amount than the increase in labor costs. The effects of this policy are clearly reflected in the steady increase in its profits per ton from a level of $9 in 1947 to an average of more than $20 in 1951. I hasten to add that I do not object to any conscionable increase in profits which an industry may be able to achieve in a free and competitive market. I agree also that profits increased not only because of the sharp price increases but also as a result of greater efficiency. To my mind, however, these figures are sufficient to disprove the contention of the steel industry that every increase in its employment costs is promptly matched by an equal increase in its other costs.

In view of the vital importance of this specific issue, I should like to restate my position so that there may be no misunderstanding. I am ready at this time to give every appropriate consideration under our existing standards to the cost increases which will result directly from any wage settlement. I cannot, and will not, so long as I am Director of Price Stabilization, take into account wholly unsupported guesses as to what may happen to costs in the future. If new cost increases materialize, I will then be prepared to review their impact and to determine what further action is necessary.

For our purposes, the cost increases with which the industry is confronted are limited to the wage increases which will emerge from the present union negotiations. As I have shown, if the entire WSB recommendation were put into effect, the cost increase would range from $4.50 to $6 per ton, depending on the time period assumed in the calculation.

Profits per ton of steel

How would such cost increases compare with present and recent steel earnings?

The chart which I now wish to present not only shows labor costs and steel prices, which I have already discussed. It also shows profits per ton of steel in recent years. Before income and excess-profits taxes, the industry's earnings increased from $9 per ton in 1947 to over $20 in 1951. During the 3-year period 1947–49 earnings averaged slightly more than $11 per ton.

If we use the outside figure of $6 per ton as the cost of the wage increase, and assume other conditions unchanged, the average profit per ton for the 18-month period January 1952–June 1953 would fall to about $14. But under the Capehart amendment, the steel industry will receive a price increase averaging almost $3 per ton. Thus, after the wage increase and the Capehart price increase, profit per ton for these 18 months would be about $17. For the year 1952 the profits per ton should not be less than $18. These compare very favorably with the average profit of $11 per ton during the very prosperous pre-Korean base period.

Steel and the Earnings Standard

These figures suggest clearly that the industry could not qualify for price increases under the Industry Earnings Standard. Let us see for a moment how the Industry Earnings Standard would apply to steel. We have two sets of data which can be used for Earnings Standard calculations.

This chart represents the official Government estimates of earnings for the entire primary iron and steel industry. This shows earnings before taxes rising from $1,070 million in 1947 to $2,500 million in 1951. The average for the base period was $1,200 million, and the earnings required by the standard in 1951, $1,312 million. Thus the industry could absorb cost increases of almost $1,200 million before a price increase would be required. The source of these figures is the Federal Trade Commission, which used data collected both by itself and by the Securities and Exchange Commission. The figure for 1951 includes a conservative OPS estimate for the fourth quarter of 1951.

The second set of data relate to the membership of the American Iron and Steel Institute, which covers most of the steel industry more narrowly defined—that is, producers of ingots and the standard finished and semifinished rolling-mill products.

The chart which I will present to you in a moment, shows the calculation of the Earnings Standard for this second series. You will see that, although profits for the entire industry broadly defined are roughly 30 percent higher than for the Steel Institute membership, the patterns are nearly identical. We could trace through the calculations with either set, but let us use the industry's own figures so that there can be no mystery about the arithmetic.

As the chart shows, the industry earned $843 million, on the average, during the 1947–49 base period. This represented a return of 18.5 percent on net worth, or owners' investment. Taking 85 percent of this rate gives a minimum rate of return under the Earnings Standard of 15.7 percent on net worth. Applying this rate to current net worth would produce a current minimum earnings figure of $936 million, shown as the last bar on the chart.

Actual 1951 earnings were $1,918 million. Thus the industry could absorb cost increases amounting to a little less than a billion dollars, the difference between these last two bars. (I should add that these figures are based upon the earnings statement of the companies themselves and include provision not only for emergency amortization on the basis of tax certificates, but also for accelerated depreciation which is not deductible under the tax laws. If normal depreciation methods were used throughout, the 1951 comparison would probably be substantially more favorable.)

We estimate that these companies produced about 75 million tons of finished steel in 1951. Dividing the amount which the industry could absorb ($982 million) by 75 million tons, shows that they could absorb a cost increase of $13.09 per ton, more than two or three times the amount of the expected wage cost increase, depending on the time period you wish to use to compute the cost increase.

Let us, however, assume an average labor cost increase of $6 per ton—which is the highest possible estimate of the effect of the WSB package over the next 14 months, including the cost of its retroactive features. Subtracting a price increase under the Capehart amendment of almost $3 per ton would yield a net cost increase of roughly $3 per ton. This would mean a total earnings reduction of $225 million, based on 1951 production rates. Subtracting this from actual 1951 earnings would still leave $1,693 million. This represents a return of more than 28 percent on stockholders' investment. This return is far higher than the 1947–49 return for these companies of 18½ percent, which I showed you earlier was itself higher than any the industry had enjoyed since 1918.

Earnings after taxes

I should perhaps digress a moment to consider one objection which the industry has made to our Earnings Standard and its application to steel. I am referring to the fact that the standard is based on profits before, rather than after, income and excess-profits taxes. I want to say most emphatically that profits after taxes cannot be used as a basis for price-control policy.

Congress, in enacting tax legislation, expresses its judgment as to the manner in which the tax burden should be allocated. The tax increases which have been required during this period of emergency similarly reflect the judgment of Congress as to how the added burden of defense costs should be distributed. If the contention of the steel companies were accepted, it would mean that OPS was, in effect, altering this congressional decision by permitting certain industries or certain groups of the population to shift their just share of the tax burden to those less able to support it.

By the same token, simple justice would require that personal taxes should be included in measuring changes in living costs and that workers would therefore be entitled to correspondingly larger cost-of-living adjustments in their pay. Similarly, taxes would have to be included as an element in farmers' costs and parity levels would have to be raised accordingly.

If each group in the economy should thus attempt to avoid its share of the burden of mobilization, by shifting that burden to someone else, the only result would be to generate a new inflationary spiral. The economic burden of mobilization will not disappear merely because each group tries to shift it to another. The net result could only be to shift, through further inflation, the entire burden of the defense program onto those individuals and industries who, because of their weaker economic position, were unable to "pass the buck" farther along the line. Since it is these groups in the population which are already suffering most from the inflation which has occurred, the burden on them would soon become intolerable.

In view of these considerations, it is the position of the Office of Price Stabilization that the tax burden should rest where Congress imposed it, and that the agency should take no steps which would have the effect of shifting this burden to those less able to support it.

While I believe that this matter of principle is the most important consideration, I might also point out that even if we were to apply our earnings standard to profits after taxes, it would not change the results as far as the steel industry is concerned. The decision of Congress to levy an excess-profits tax naturally causes steel-industry profits after taxes to compare less favorably with those of the pre-Korean base period than do the before-tax profits. Nevertheless, the increase in steel profits has been so large that even profits after taxes now exceed the pre-Korean profits after taxes—and exceed them by so much that the steel industry would probably not be eligible for price increase, at least during the balance of 1952. I have thrown so many numbers at you already this afternoon that I shall not trouble you with the arithmetic. But I assure you that this is correct, and I will be glad to demonstrate it if you should so desire.

The effects of an unwarranted steel-price increase

I believe that I have fully explained why we think that the steel industry needs no increase in its ceiling prices beyond what is available under the Capehart amendment.

There are those who understand and accept this position but who feel, nevertheless, that in the interest of peace and harmony it would be well to yield in just this one case. They ask: How much harm could it do?

We believe that to yield would cause irreparable damage to our stabilization program. It would do this in two ways.

The first damage would occur as the direct result of a large and unnecessary increase in steel prices. An increase of $12 a ton would immediately add a billion dollars a year to the cost base of our economy. But the ultimate cost would be greater because, under existing law and regulations, such an increase would have to be pyramided in the course of the final production and distribution of steel products. Thus, under the Herlong amendment, any increase in manufacturers' prices for such products as automobiles, refrigerators, agricultural equipment or industrial supplies, would be subject to the distributors' normal percentage mark-ups at both wholesale and retail level. Similarly, increased construction costs would also be augmented by the profit margin allowed to construction firms. The billion dollars could easily rise to a billion and a half.

Moreover, the impact would not stop there. Increased costs of utility construction or of railroad equipment would increase the rate base of utilities and railroads and lay the ground for rate increases in accordance with the usual rules established by regulatory bodies. Increases in the costs of construction, machinery, and equipment would substantially raise future capital charges for a wide range of industries. Increased costs of direct Government purchases would increase the Federal deficit and swell inflationary pressures. The magnitude of increases of this character cannot be measured precisely but it certainly would be substantial.

All of this ignores further secondary effects. Higher prices for farm machinery and fence wire and other products bought by farmers would raise the parity index, and thus the minimum level of ceilings for farm products. And a higher cost of living would—under present wage regulations—permit further increases in wage rates.

It has been repeatedly emphasized that our success in holding the price line during the past 12 months has reflected in large part a change in psychology among consumers and business alike. The reestablishment of confidence in the stability of the price structure and the value of the dollar were major factors in stemming the panic buying which preceded the issuance of the General Ceiling Price Regulation. The importance of this factor is clearly reflected in the sharp increase in savings of the past year.

By the same token, any reversal of business or consumer psychology would almost surely lead to a reduction in the rate of savings and the renewal of broad buying pressures. While the extent of this change is unpredictable, there is little doubt that it would be serious and it might be catastrophic. A reading of the press will show that everyone is concerned lest the steel issue result in a new turn of the inflationary spiral.

You will notice that I assumed above that the increased cost of steel would be passed along by manufacturers of steel products, and then further pyramided by distributors. I make this assumption for one simple reason. If the steel industry, whose margins are as generous as I have shown them to be, were not required to absorb cost increases, we could surely not require steel users, whose margins are in general much lower, to assume any burden of cost absorption.

I have shown in detail how much better off the steel industry is profitwise than it was in the base period. Steel profits in 1951 exceeded the base period rate by more than 80 percent. For manufacturing industry generally, however, the comparison is far less favorable. Latest data suggest that manufacturers' earnings on the average exceed the base period rate by only about 18 percent. This is the reason why I assume that if steel is required to absorb nothing, steel users cannot fairly be required to absorb higher steel prices.

This leads me to the second and much more serious effect of bowing to steel's demands. If we were to break our price control standards for steel, how could we hold them elsewhere? Despite the obvious injustice of this position, we might try to continue to say to other industries: "Absorb cost increases until our standards require a price increase for you." But, having bowed under pressure to steel, we would be fair game for intimidation by other groups. If we give in to an industry which brings on a strike—and Government seizure of its plants—because it insists on a price increase as a requirement for granting any wage increase, we will hardly be in strong position to stand up against another industry which refuses to ship essential products until it receives a price increase not permitted by our standards.

Sooner or later we would be forced, at a minimum, to develop a policy of passing along all cost increases—of automatic escalation all up and down the line. And we would probably have to recognize not only all future cost increases but all of the past cost increases which have occurred since the beginning of price control and have thus far been absorbed.

Perhaps you do not realize how many industries have been required to absorb cost increases in the past 15 months. There have been extensive wage increases all during 1951, as well as freight-rate increases, and higher prices for imported materials as well as some domestic ones. Some of these higher costs have had to be recognized under our standards. But many more have been absorbed.

I say to you in all seriousness if price-control policies were to come to this, we had better have no price control at all. For we would then have an inflationary machine, operating under Government auspices, which was geared to spin our economy into a dizzy spiral of ever higher prices, wages, costs, and prices.

I realize that this has been a long statement, but I believe that in view of the seriousness of the situation it is urgent that there be a full understanding of all the facts. Let me summarize the principal points which I have made.

First. The problem of a steel price increase cannot be looked at in isolation. Requests for price increases by any industry must be judged in accordance with existing law and generally applicable standards. Only thus can the rule of law be preserved.

Second. The maximum possible increase in employment costs which would result from the Wage Board's recommendations is about $6 per ton. The full impact of this increase would not be felt during 1952, but it would represent the average cost over the next 14 months, including an allowance for retroactive wage increases to last January, but with no allowance for productivity increases.

Third, I have explained the basis for the steel companies' contention that the cost of the Wage Board's recommendations to them would amount to $12 per ton. I have emphasized that, entirely apart from the fallacious basis for this claim, it would be utterly impossible to take into account wholly unsupported fears of possible future cost increases in the administration of price control.

Fourth, I have shown that the maximum net increase in costs to the steel industry, after allowing for the Capehart adjustment, is about $3 per ton. This would still leave profits before taxes at about $17 per ton—far in excess of their pre-Korean level. In the face of so high a level of profits, the industry obviously could not qualify for price adjustments under the Industry Earnings Standard.

Next, I have explained why profits after taxes cannot be used as the basis for determining an industry's need for price adjustments. But, even if they were so used in this case, the steel industry could not qualify for any price increase beyond that allowed under Capehart.

And, finally, I have stressed my belief that to yield in this case to the insistence for a large price increase in violation of all our standards, would be extremely serious from the point of view not only of the stabilization program but of the basic health of our entire economy.

These are the reasons why my agency has taken so strong a position on the question of steel prices. Perhaps the Congress and the public no longer want price control. Perhaps a "peaceful" wage settlement in steel is more to be desired than a continuance of our stabilization program, which up to now has operated with reasonable success.

I ask only that we consider all of the facts and alternatives before we make that decision. Until I am told otherwise, I shall assume that my job, and that of my agency, is to carry out the purposes of the Defense Production Act. I have been trying to do just that in the present steel issue.

As long as I am Director of the Office of Price Stabilization, I shall carry out the law governing the operation of this agency.

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